

FLORIDA FUNDING II LLC
FINANCIAL STATEMENTS
December 31, 2011

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REPORT OF INDEPENDENT AUDITORS

Member and Managing Agent
Florida Funding II LLC

We have audited the accompanying balance sheet of Florida Funding II LLC (the "Company"), as of December 31, 2011, and the related statements of income and member's equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing our opinion on the Company's internal control over financial reporting, accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Florida Funding II LLC as of December 31, 2011, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 30, 2012, on our consideration of Florida Funding II LLC's internal control over financial reporting. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and the results of that testing and not to provide an opinion on internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Crowe Horwath LLP

New York, New York
April 30, 2012

FLORIDA FUNDING II LLC
BALANCE SHEET
December 31, 2011
(In thousands)

ASSETS

Cash and cash equivalents	\$	289
Securities, including accrued interest receivable		151,650
Deferred financing costs		15
Other assets		<u>8</u>
Total assets	\$	<u>151,962</u>

LIABILITIES AND MEMBER'S EQUITY

Accrued expense	\$	175
Secured liquidity notes ("SLNs"), including accrued interest expense		<u>151,787</u>
Total liabilities		151,962
Member's equity		<u>-</u>
Total liabilities and member's equity	\$	<u>151,962</u>

See accompanying notes to financial statements.

FLORIDA FUNDING II LLC
STATEMENT OF INCOME AND MEMBER'S EQUITY
Year ended December 31, 2011
(In thousands)

Revenues

Increase in fair value of securities, including interest income and realized loss of principal	\$ 29,911
Decrease in fair value of pass-through SLNs, including interest expense	<u>(29,600)</u>
Total revenue	<u>311</u>

Expenses

Fees and operating expenses	<u>311</u>
Total expenses	<u>311</u>

Net income

-

Member's equity at beginning of year

-

Member's equity at end of year

\$ -

See accompanying notes to financial statements.

FLORIDA FUNDING II LLC
STATEMENT OF CASH FLOWS
Year ended December 31, 2011
(In thousands)

Cash flows from operating activities	
Net income	\$ -
Adjustments to reconcile net income to net cash provided by operating activities	
Net (gain) loss on securities held under fair value option	(37,529)
Net (gain) loss on SLNs under fair value option	27,498
Realized loss of securities principal	9,908
Changes in operating assets and liabilities	
Decrease in deferred financing costs	10
Decrease in other assets	6
Increase in interest receivable	(9)
Increase in interest payable	1
Increase in accrued expenses	152
Net cash provided by operating activities	<u>37</u>
Cash flows from investing activities	
Proceeds from sales of securities	<u>33,316</u>
Net cash provided by investing activities	33,316
Cash flows from financing activities	
Payments of SLNs	<u>(33,343)</u>
Net cash used by financing activities	<u>(33,343)</u>
Net increase in cash and cash equivalents	10
Cash and cash equivalents at beginning of year	<u>279</u>
Cash and cash equivalents at end of year	<u><u>\$ 289</u></u>

See accompanying notes to financial statements.

FLORIDA FUNDING II LLC
NOTES TO FINANCIAL STATEMENTS
December 31, 2011
(In thousands)

NOTE 1 - ORGANIZATION

Florida Funding II LLC (the "Company"), a Delaware limited liability company, was formed on May 14, 2010. The initial member of the Company is Florida Funding Holding Corp. (the "Member") The State Board of Administration (the "SBA") acts as the Managing Agent on behalf of various Noteholders who assigned their interest in certain secured liquidity notes ("SLNs") to the Company on June 8, 2010, in return for a Secured Note. The sole and exclusive purpose of the Company is to liquidate underlying securities and distribute the proceeds of such liquidation as soon as reasonably and commercially practicable and not to engage in a trade or business.

The Company and the SBA acting on behalf of note holders have engaged Lord Securities Corporation (the "Manager") to provide administration services. The Manager receives an administration fee for these services, which is periodically agreed upon with the Company and the SBA, and such fees are included in the fees and operating expenses in the statement of income and member's equity.

The Company and the SBA acting on behalf of Noteholders have engaged Stone Tower Debt Advisers, LLC ("Stone Tower") effective June 2011 to provide investment management and advisory services. Prior to the engagement of Stone Tower, the Company's investment management and advisory services were provided by the SBA. Stone Tower receives fees for these services, which are periodically agreed upon with the Company and the SBA. The fees for Stone Tower are paid for directly by the SBA, are not reflected in fees and operating expenses, and total \$113.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: The fiscal year end of the Company is December 31, 2011. The Company maintains its accounting records on the accrual basis of accounting, and its financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Use of Estimates: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain amounts reported in the financial statements and accompanying notes. As a result of unanticipated events and circumstances, actual results could differ from those estimates.

Fair Value Estimates: The Company applies Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, which provides guidance for using fair value to measure assets and liabilities. ASC 820 establishes a three-level hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable input be used when available. Observable inputs are used by market participants in pricing the asset or liability based on market data obtained from sources independent of the Company.

Unobservable inputs reflect management's assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. In instances where the determination of the fair value measurement is based on input from more than one level of the fair value hierarchy, the entire fair value measurement is classified based on the lowest level input that is significant to the fair value measurement in its entirety.

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FLORIDA FUNDING II LLC
NOTES TO FINANCIAL STATEMENTS
December 31, 2011
(In thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The hierarchy is measured in the following three levels based on the reliability of inputs:

Level 1: Valuations are based on quoted prices in active markets for identical assets as of the reporting date.

Level 2: Valuations are based on pricing inputs that are other than quoted prices in active markets, which are either directly or indirectly observable at the reporting date.

Level 3: Valuations are derived from other valuation methodologies, including pricing models, discounted cash flow models, and similar techniques. Level 3 valuations incorporate certain assumptions and projections that are not observable in the market and require significant professional judgment in determining the fair value assigned to such assets or liabilities.

As of December 31, 2011, the securities held and SLNs issued by the Company were measured using Level 3 based inputs.

The Company used the following methods and significant assumptions to estimate fair value:

Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

SLNs: As a practical expedient, the fair value for SLNs is determined based on the assets of the Company less accrued expenses and member's equity (Level 3), given the pass-thru nature of the SLNs and the lack of a readily determinable fair value.

Cash and Cash Equivalents: The Company defines cash equivalents as short-term, highly liquid securities with original maturities of three months or less.

Restrictions on Cash: Cash on hand or deposit is required to be paid to the SLN note holders based upon the SLN agreements.

Securities: The Company's securities are carried on the balance sheet at fair value pursuant to the election of the fair value option. Unrealized gains and losses are included in the statement of income and member's equity. Given the pass-through nature of the Company and related SLNs issued, management believes fair value is the most appropriate accounting method.

Interest Income: Interest income on investments is recognized net of fair value adjustments on the balance sheet and included in the statement of income and member's equity.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through April 30, 2012, which is the date the financial statements were available to be issued.

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FLORIDA FUNDING II LLC
NOTES TO FINANCIAL STATEMENTS
December 31, 2011
(In thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentration of Credit Risk: The Company's securities are concentrated in illiquid commercial and residential housing securities as well as other asset backed securities and private placements with no or low investment ratings collateralized through both first and second lien properties; therefore, the Company's exposure to credit risk is significantly affected by changes in the collateral underlying the securities.

Equity: The Member contributed one hundred dollars in exchange for all member interests. No additional contributions are required or committed. Upon the termination of the Company, this capital contribution will be returned. Based upon the SLN agreements all earnings accrue to the SLN Noteholders.

Dissolution and Term: The Company shall continue indefinitely unless sooner terminated by the SBA.

Dividend Restriction: The SLN agreements restrict payments of dividends or return of capital to the Member.

SLNs: The Company's SLNs mature June 8, 2017, and are pass-through in nature whereby all cash flows are subjected to a waterfall with payments first being remitted to the Manager and next being remitted to other service providers before payment to the SLN Noteholders. No income or loss accrues to the Member. The SLNs are accounted for at fair value including accrued interest on the balance sheet with unrealized gains and losses included in the statement of income and member's equity.

Interest Expense: Interest expense on the SLNs is recognized net of fair value adjustments on the balance sheet and included in the statement of income and member's equity.

New Accounting Pronouncement: In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-6, *Improving Disclosures About Fair Value Measurements*, which adds new disclosure requirements about recurring or nonrecurring fair value measurements, including transfers into and out of Level 1 and 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. ASU 2010-6 was effective for financial statements for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures, which were effective for annual periods beginning after December 15, 2010.

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FLORIDA FUNDING II LLC
NOTES TO FINANCIAL STATEMENTS
December 31, 2011
(In thousands)

NOTE 3 - SECURITIES

The table below summarizes the components of the value of securities accounted for under the fair value option method at December 31, 2011:

	<u>Remaining Par</u>	<u>Fair Value Adjustments</u>	<u>Accrued Interest Receivable</u>	<u>Fair Value</u>
Asset-backed securities	\$ 69,829	\$ (33,623)	\$ 37	\$ 36,243
Asset-backed securities (foreign)	1,903	(571)	2	1,334
Collateralized mortgage obligations	182,182	(91,364)	92	90,910
Private placements	25,749	(7,752)	18	18,015
Commercial mortgage-backed securities	<u>6,049</u>	<u>(906)</u>	<u>5</u>	<u>5,148</u>
Total securities	<u>\$ 285,712</u>	<u>\$ (134,216)</u>	<u>\$ 154</u>	<u>\$ 151,650</u>

The table below presents a summary of the activity related to securities accounted for under the fair value option and a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31:

	<u>2011</u>
Balance of recurring Level 3 assets at January 1	\$ 157,336
Change in accrued interest	9
Net gain on securities held under fair value option	37,529
Realized loss of securities principal	(9,908)
Paydowns of securities principal	(33,316)
Transfers in and/or out of Level 3	<u>-</u>
Balance of recurring Level 3 assets at December 31	<u>\$ 151,650</u>

The net gain on securities held under the fair value option is attributable to the change in securities held at December 31, 2011.

All securities are pledged as collateral for SLNs at December 31, 2011.

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FLORIDA FUNDING II LLC
NOTES TO FINANCIAL STATEMENTS
December 31, 2011
(In thousands)

NOTE 4 - SECURED LIQUIDITY NOTES

The Company's SLNs bear an interest rate at a pass-through rate of interest and have a maturity date of March 25, 2017. The difference between fair value and aggregate unpaid principal balance of the SLNs at December 31, 2011, is:

	<u>Aggregate Unpaid Principal Balance</u>	<u>Fair Value Adjustments</u>	<u>Accrued Interest Payable</u>	<u>Fair Value</u>
FF-II-1	\$ 159,548	\$ (69,598)	\$ 8	\$ 89,958
FF-II-2	<u>109,660</u>	<u>(47,836)</u>	<u>5</u>	<u>61,829</u>
Total SLNs	<u>\$ 269,208</u>	<u>\$ (117,434)</u>	<u>\$ 13</u>	<u>\$ 151,787</u>

The table below presents a summary of the activity related to SLNs accounted for under the fair value option and a reconciliation of all liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31:

	<u>2011</u>
Balance of recurring Level 3 assets at January 1	\$ 157,631
Change in accrued interest	1
Net loss on SLNs under fair value option	27,498
Repayments of SLNs	(33,343)
Transfers in and/or out of Level 3	<u>-</u>
Balance of recurring Level 3 assets at December 31	<u>\$ 151,787</u>

The net loss on SLNs under the fair value option is attributable to the change in SLNs outstanding at year end.

NOTE 5 - INCOME TAXES

No provision for federal and state income taxes has been made in the accompanying financial statements because the Company is treated as a partnership for federal and state income tax purposes. Instead, earnings and losses are included in the returns of the Member. Accordingly, these financial statements do not reflect a provision for income taxes.

In accordance with authoritative guidance on how to account for uncertainty in income taxes, the Company has determined that no material unrecognized tax benefits or liabilities exist as of December 31, 2011. If applicable, the Company will recognize interest and penalties related to underpayment of income taxes as income tax expense. As of December 31, 2011, the Company had no amounts related to unrecognized income tax benefits and no amounts related to accrued interest and penalties.

REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Member and Managing Agent
Florida Funding II LLC

We have audited the financial statements of Florida Funding II LLC (the "Company") as of and for the year ended December 31, 2011, and have issued our report thereon dated the same date as this report. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on

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the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Company's management, the Manager and Managing Agent, others within the entity, and legal and regulatory bodies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Crowe Horwath LLP". The signature is written in a cursive, flowing style.

Crowe Horwath LLP

New York, New York
April 30, 2012